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Keywords

Human Capital, Human Capital Reporting, Sri Lanka, Knowledge Economy, Annual Reports, Content Analysis, Intellectual Capital, Developing Nation

Disciplines

Accounting | Business | Social and Behavioral Sciences

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Human Capital Reporting in a Developing Nation

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Human Capital Reporting in a Developing Nation

Abstract

In recent years, a trend in management has been the introduction of human capital (HC) management and accounting. As a result of this trend, there has been a demand from external stakeholders for a different sort of information, and many firms have, in an attempt to meet this demand, become more involved in the creation, measurement and reporting of information other than 'financial' data. Using the method of content analysis, this paper reports on human capital reporting (HCR) practices taken from a sample of firms in Sri Lanka, a developing nation. The paper aims first to examine the disclosure patterns of HCR observed in the Sri Lankan sample, and second to speculate upon the differences in disclosure patterns between Sri Lanka and developed nations.

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HUMAN CAPITAL REPORTING IN A DEVELOPING NATION

1. Introduction

Traditionally, firms have relied heavily on tangible assets to determine value. More recently, in the emerging 'knowledge economy', value can be increasingly seen to reside in intellectual capital (IC) such as knowledge and information – assets that are generally embodied in people. Many conceptual frameworks have been created in order to understand, codify and examine IC. For IC the definition is taken from Petty & Guthrie (2000, p.158), that is, IC is the economic value of two categories of intangible assets of a company: (a) organisational (structural) capital; and (b) human capital (HC). Structural capital refers to elements like business processes, software systems, supply chains and HC refers to staff competencies and the competencies of external stakeholder human resources available to the firm. An early attempt at creating a model to measure and report on IC was developed by Brooking (1996). Subsequent authors have modified and expanded upon Brooking's original framework. One such recent framework (Guthrie, Petty, Yongvanich & Ricceri, 2004) describes IC as being made up of the following three components: internal (structural/organisational) capital; external (relational/customer) capital; and human capital. It is increasingly being understood that HC and IC are, in general, invaluable assets in contemporary knowledge-driven economies (Edvinsson & Sullivan, 1996; Graham & Pizzo, 1998; Backhuijs, Holterman, Oudman & Zijlstra, 1999; Bontis, 2003). For instance, Edvinsson & Sullivan (1996) argue that managing IC is about managing knowledge and leveraging HC. HC is a component of IC, for a firm's knowledge is stored within its employees, and organisational assets flow-on from the firm's ability to utilise its employees. HC is vital as it is the component of IC that gets transformed into value through the medium of structural capital (Backhuijs *et al.*, 1999; Edvinsson & Sullivan, 1996).

This development has important implications for the workforce, indicating that the management of HC will continue to grow in importance. The recognition that employees are valuable assets will mean that different assumptions will have to be made regarding the methods of managing people. A necessary foundation for this change will be the ability of a firm to identify and codify the contribution of HC.

The need for firms to be able to effectively manage, measure and report on intangible assets has led to the development of a number of measurement tools such as content analysis. In the past decade, firms such as the Skandia Group, the Canadian Imperial Bank of Commerce (CIBC), Hughes Space and Communications, Dow Chemicals Firm, Buckman Laboratories International, and Telia have incorporated the measurement of HC (among other IC measurements) into their strategic management and internal and external reports (Buckowitz & Petrash, 1997; Flamholtz & Main, 1999; Petrash, 1996; Stewart, 1994).

There has also been a noticeable shift, at least in theory, in the *attitude* of management towards their employees and in the way employee contribution to the firm is understood. Bassi, Lev, McMurrer & Siesfeld (2000, p. 334-354) revealed that the senior management of many of the top companies in the US and Europe believed their employees to be a key asset because they are the repositories containing the knowledge needed to achieve the mission of the firm. The senior management believed that HC led to increased revenue. Also, Bassi *et al.* (2000, p. 353-354) found that market analysts recognise the value of HC by placing a higher value on the stock of firms that can be seen to possess talented employees.

However, many managers have faced difficulty in retaining employees (The Economist Intelligence Unit, 1998, p.3). Part of the problem is an erosion of loyalty occasioned by restructuring undertaken by many firms (Cascio, 1998). Another part of the problem resides in the fact that knowledge workers are a scarcer resource than workers who often have opportunities to easily leave one firm to go to another (Quinn, Anderson & Finkelstein, 1996). While most firms assert that people are their chief asset, making it reasonable to expect that companies would do all in their power to retain that asset, however, the converse has been found to be true (Olsson, 2001; The Economist Intelligence Unit, 1998, p. 3).

To adequately address the issue of employee (HC) retention, companies should reform their labour practices and begin treating employees in a manner reflective of their value to the firm. As noted by Stewart (1997, p. 104), it is imperative that companies treat employees as assets, providing them with appropriate pay, prospects for promotion, skill development opportunities and a work environment that allows autonomy and creativity. Furthermore, employee motivation must be kept high, because HC is reliant upon the willingness of people to voluntarily share and apply knowledge and thereby transform it into IC.

The purpose of this research is to examine the state of Human Capital Reporting (HCR), as demonstrated in the annual reports of the largest listed Sri Lankan firms. This will allow some comparison between Sri Lanka and a developed nation, Australia; thus providing the basis for a speculative commentary on the difference between the two situations. The paper is organised as follows. The second section outlines a brief review of the HCR literature, focusing on the importance of HC to the reporting practices of a firm. Section three describes the research method employed to collect and analyse disclosures in the sample of annual reports (namely, content analysis and coded results, using frequency and line count), and

outlines details about Sri Lanka relevant to the present study. The empirical evidence from the content analysis is presented in section four, while the last section provides the summary and conclusion.

2. Human Capital Reporting (HCR) literature review

Early definitions of HC (Mincer, 1958; Schultz, 1961; Johnson, 1960; Marshall, 1961, p. 788; Lev & Schwartz, 1971, 1972) originated from the definition of capital proposed by Fisher (1930, p. 12). HC has been described in the literature by different names, such as ‘human assets’ (Likert, 1967, p. 146-155); ‘human resources’ (Brummett, Flamholtz & Pyle, 1968; Hekmian & Jones, 1967; Elias, 1972a, 1972b); ‘cultural capital’ (Thompson, 1998), ‘worth of employees’ (Roslender & Dyson, 1992), and HC (Liebowitz & Wright, 1999).

Although several different definitions of HC are found in the literature (Edvinsson & Sullivan, 1996; Grojer & Johanson, 1996, p. 17; Nasser, 1998; Roos, 1998), it has not been operationalised for accounting and reporting purposes (Bassi *et al.*, 2000, p. 334). HC refers to a combination of factors possessed by individuals and the collective workforce of a firm. It can encompass knowledge, skills and technical ability; personal traits such as intelligence, energy, attitude, reliability, commitment; ability to learn, including aptitude, imagination and creativity; desire to share information, participate in a team and focus on the goals of the organisation (Fitz-enz, 2000).

The literature on measuring and reporting HC can be classified into the following three streams.

(i) The first stream of researchers are involved in developing financial measures for financial reporting (Heckmian & Jones, 1967; Lev & Schwartz, 1971; Committee Reports, 1973; Turner, 1996; Morrow, 1996; Dobja, 1998; Ra & Langendijk, 1998). Heckmian & Jones, (1967), in their study, discuss using historical cost, replacement cost, and opportunity cost as financial measures, and they favour the opportunity cost method. The opportunity cost approach uses the implicit asset value that can be obtained based on competitive bidding. Only scarce employees become an investment and others are ignored under this approach (Committee Reports 1973). Lev & Schwartz (1971) stated that the value of a firm's human capital is the average earnings data of homogenous groups discounted at the firm's cost of capital. Turner (1996) argues to recognise human resources as both assets and liabilities. The asset aspect of human resources, he argues, is the expected future payments (such as salaries and benefits) and the liability aspect is the cost associated with staff turnover when the liability recognition criteria are satisfied. Morrow (1996) compared four measurement methods to value football players: historical cost; earnings multipliers (transfer prices between clubs arbitrated by an independent tribunal); director's valuations; and independent multiple valuations of players (by independent evaluators). The treatment of amortisation and other write offs of players is not discussed, but it is an important aspect since profits from players can produce unprecedented swings in the income statement (Ra & Langendijk 1998). However, determining the monetary value has proven to be a complex matter (Heckmian & Jones 1967) since it is not easy to isolate HC as a single variable (Elias 1972a).

The first stream of researchers developing HC measurement for reporting have, so far, achieved little progress in recognising and reporting HC in financial statements (Roslender, 1997; Fitz-enz, 2000, p. 116-117). Although it is theoretically interesting, such information

has not proved to be useful in practice and there is little empirical evidence to suggest the usefulness of these financial models (Flamholtz, 1976; Grojer & Johanson, 1996, p. 24).

One of the factors contributing to this lack of progress, achieved so far, is the valuation of employees due to a range of judgemental issues (Roslender & Dyson, 1992; Turner, 1996; Roslender, 1997). Although this stream of research is theoretically exciting, it has not proved useful empirically (Flamholtz, 1976; Grojer & Johanson, 1996, p. 24) or in practice (Grojer & Johanson, 1996). However, the models developed so far can contribute to change firm culture to reinforce that people are a valuable resource (Dozentin, Flamholtz & Bullen, 1989).

According to Roslender & Dyson (1992) putting people on the balance sheet has lost much of its status as a useful option and alternative ways of reporting human worth in a framework has not gained much acceptance among firms.

(ii) The second stream of researchers attempt to understand how users make decisions using HC measurement information. Users include both managers (Lev & Schwartz, 1971; Flamholtz, 1971, 1972; Flamholz & Holmes, 1972; Ronen, 1972; Copeland, Francia & Strawser, 1973; Jaggi & Lau, 1974; Tomassini, 1976, 1977; Johanson & Nilson, 1996; Olsson, 1999), and investors (Elias, 1972b; Hendricks, 1976; Bassi *et al.*, 2000, p. 353-354). However, the use of surrogates in some of their studies has reduced the validity of their findings (Committee Reports, 1973; Copeland *et al.*, 1973; Tomassini, 1977). This stream of IC literature has also begun to explore the influence reporting employment relationships of HC has on the managements' decision making (Handy, 1995; Kasper-Fuehrer & Ashkanasy, 2001; Raghuram, Garud, Wiesenfeld & Gupta, 2001).

Human resource accounting is an attempt to report the financial consequences of human resource development, readjustment, reshuffling, acquisition, and turnover. It focuses on the knowledge of the organisation based on principles used in traditional accounting methods and has financial consequences because of payments received by employees (The Danish Trade and Industry Development Council, 1998, p. 20).

(iii) The third stream of researchers are involved in using theoretical models to explore how HC is measured and reported by firms. Recent studies in this stream have been conducted in Australia (Guthrie & Petty, 2000; Guthrie, Petty, Ferrier & Wells, 1999), Canada (Bontis, 2003), Ireland (Brennan, 2001), Sweden (Olsson, 2001), and inter-country (Subbarao & Zeghal, 1997).

In summary, HC refers to a combination of factors possessed by individuals and the collective workforce of a firm. ‘Human resource accounting’ is an attempt to report the financial consequences of such factors. The difficulty of accurately determining the monetary value of HC is cited as a reason for the lack of progress in recognising HC in traditional accounting statements and therefore the need to report in other forms, including the annual report.

In this section, a brief review of the HCR literature will be provided. Several trends and developments will be highlighted, most notably the dearth of studies on HCR in developing nations.

The Organisation for Economic Co-operation and Development (OECD) describes IC as the “economic value of two categories of intangible assets of a firm: organisational (‘structural’)

capital and human capital” (OECD, 1999). Organisational Capital includes the intangible aspects of a firm such as its processes, culture, relationships and intellectual property. Examples of these facets of Organisational Capital include: manufacturing methods, distribution systems (processes); expectations, rituals, real rewards and punishments, myths (culture); relationships with customers, suppliers, community and other stakeholders (relationships); and, brand, trademark, copyright, intellectual assets derived from employees (intellectual property). HC refers to a combination of factors possessed by individuals and the workforce of a firm. It encompasses: knowledge, information and data; skills and technical ability; personal traits such as intelligence, energy, attitude, reliability, and commitment; ability to learn, including aptitude, imagination and creativity; and, the desire to share information, participate in a team and focus on the goals of the firm (Fitz-enz, 2000).

Part of the IC literature has attempted to use annual reports to ascertain degrees of, and trends in, Intellectual Capital Reporting (ICR), and within this HCR. This research has mainly been comparative, seeking to compare reporting practices either between firms, industries or countries (Guthrie *et al.*, 2004 forthcoming). It is necessary to review several of these studies to ascertain the status of ICR in the developed world, before comparisons with the situation in Sri Lanka can be made. To this end, firms reporting in Australia (Guthrie & Petty, 2000; Guthrie *et al.*, 1999), Canada (Bontis, 2003), Ireland (Brennan, 2001) and Sweden (Olsson, 2001) will be examined, and a more general study by Subbarao & Zeghal (1997) will be presented. These previous studies offer a platform with which to understand and compare the findings of this study.

Subbarao & Zeghal (1997) analysed the annual reports of a sample of publicly traded corporations in six developed countries, namely, the USA, Canada, Germany, the UK, Japan

and South Korea, in an attempt to draw out an international comparison of human resource information and disclosure. The authors analysed annual reports from the manufacturing and financial service sectors in each country. A sample of 120 corporate annual reports from listed enterprises were analysed, comprising 20 reports from each of the six countries, with 10 from the manufacturing sector and 10 from the financial services sector. They found that the size of the reporting entity had an effect on the amount of disclosure in the annual report.

The authors recorded both the incidence and the length of the HC information (via a word count) within five broad categories: information on training (training); information related to the contribution of human resources to increasing the value of the corporation (value-added); diversity of the workforce as a responsible corporation (equity issues); information about relations with employees (employee relations); and compensation of executives and employees (compensation). They found that the value-added by human resources to a corporation was the least frequently disclosed item. The authors argue that this was either because the corporations found it difficult to measure this construct, or because they felt that value-added information was unimportant. Employees featured for special contributions, and the directors' committee of human resources ranked first and second by word count, but fifteenth and eighteenth respectively by frequency of disclosure. While it was also found that benefits and pensions were the most frequently disclosed information, this reflects the fact that such disclosures are required by statute in most of the countries studied.

The Subbarao & Zeghal (1997) study is largely descriptive, and has little evidence of a critical analysis, with no questioning or discussion of their findings or methodology. However, their work is relevant to the present study in that it offers findings that illustrate differences in HCR between developed countries.

Researchers in Australia, also a developed nation, have also examined organisational practices in managing and reporting IC (including HC). Guthrie & Petty (2000) carried out a content analysis of the annual reports of the largest Australian listed companies (by market capitalisation) in an attempt to understand the extent to which these companies report their IC. Their analysis consisted of a frequency count. The authors also carried out several interview case studies in an attempt to provide a greater understanding of how firms identify, manage, measure and report IC. In analysing IC, the authors used a framework developed by Sveiby (1997), which categorises intangibles into three groups: internal structure; external structure; and employee competence. Using this framework, it was found that the key components of IC are poorly understood, inadequately identified, inefficiently managed and inconsistently reported.

A study that examined 10,000 Canadian firms using content analysis also found that there is no evidence at all that IC disclosure has garnered any traction for Canadian firms. Only a small proportion of Canadian firms even used the terms in their annual reports and argued that the use of the IC language is an important antecedent to developing IC statements. Although IC has a very strong impact on the drivers of future earnings, it was found that it was largely ignored in financial reporting (Bontis, 2003).

Brennan (2001) carried out a similar study of technology and people orientated companies in Ireland. The author analysed the annual reports of 11 listed companies and 10 private companies. Although the author used an identical framework to code data for the content analysis of annual reports and has reported results similar to the Australian study,

fundamentally, the findings of the study are not comparable with Guthrie *et al.* (1999) because of the sample selection.

A study by Olsson (2001) examined the annual reports of the 18 largest Swedish companies, selected on the basis of market capitalisation in the Swedish stock market. She developed a list of five elements to ascertain the level of HCR: education and development; equality; recruitment; selection of employees; and comments by CEOs about personnel. The study found that, in 1998, none of the 18 companies reported more than 7% on human capital information (as a proportion of total information) in their annual reports. Furthermore, the information that was reported was found to be highly deficient in either the quality or the extent of the disclosure.

In Sri Lanka there also exists an accounting framework, similar to the Statement of Accounting Concept papers in Australia (Accounting Handbook, 2003, p. 1-95; SLAS, 1999). However, as in the case of Australia, the accounting standards in Sri Lanka do not address the issue of HCR. It appears that accounting regulators in Sri Lanka have demonstrated a decided reluctance to recognise HC in financial statements (The Sunday Times, 1999a; b). Therefore any reporting of HC in a Sri Lankan annual report or financial statement is voluntary.

3. Research methods

The aim of this study is to understand the degree of emphasis these firms place on employees and IC, via HCR. To achieve this aim, the research undertook the following three specific objectives: first, to develop HC disclosure content categories from the research literature, providing a tool that will then be used to assess the type, amount and quality of HCR disclosures; second, to apply this HC disclosure content tool to a sample of Sri Lankan firms'

annual reports; third, to use the results to contribute to the development of ICR in developing nations, with a view to making several recommendations for HCR practice.

As indicated above, several studies have been carried out to ascertain the status of IC as reported by firms in developed economies, however, virtually no studies have been carried out in the context of a developing economy. The case of Sri Lanka presents an excellent opportunity to redress this imbalance. While Sri Lanka is a lower middle income, developing country, its adult literacy rate is substantially above the world average, and significantly higher than other developing countries (UNDP, 1998, p. 5, 42). Sri Lanka thus possesses an unusual level of HC for a developing nation. Being in many other ways a poor nation, HC emerges as one of Sri Lanka's most important resources, making the management of HC potentially very pertinent to the Sri Lankan context.

Annual reports, present a unique communication opportunity for firms, allowing them to go beyond the simple reporting of financial information by incorporating IC reporting so as to reflect the firm's value and position (Clackworthy, 2000). As this study focuses on the external reporting of HC, annual reports are an ideal tool with which to examine a firm's HCR practices.

The companies chosen for the current research were selected on the basis of their market capitalisation. This method of selection was based on the findings of previous research into the voluntary reporting of environmental (Kirkman & Hope, 1992) and social (Andrew Gul, Guthrie & Teoh, 1989) information. Content analysis was carried out on the original annual reports of the top 30 listed companies in the CSE, based on market capitalisation for two consecutive years. These top 30 firms represent around 60% of the market capitalisation of

the CSE in Sri Lanka. Therefore, the sample taken for the study has a substantial representation of firms listed in the CSE. The head offices of the firms in the sample are located in Colombo, the capital of Sri Lanka. It was found that firms with the largest market capitalisation tend to lead the way insofar as the voluntary reporting of IC is concerned. At the same time, it should also be noted that other firms may well be actively involved in the creation and maintenance of IC, such as unlisted private sector firms (for example, Unilever Sri Lanka), public sector corporations, and other public sector firms able to match the capitalisation of the bigger firms listed in the stock exchange (for example, Sri Lanka Telecom and Bank of Ceylon). An examination of such firms, while potentially fruitful, has been deemed beyond the scope of this study due to restricted access to comparable external reports such as the annual reports of such firms.

One popular framework for measuring HC is that proposed by Brooking (1996, p. 12-81, p. 129; Brooking & Motta, 1996). Brooking's framework has since been expanded by other researchers (ASCPA & CMA, 1999, p. 14; IFAC, 1998, p. 7; Dzinkowski, 1999; 2000; Guthrie & Petty, 2000). The present study uses this expanded framework, but with further modifications with regard to equity issues, HC relations, HC measurement and training and development. The 25 attributes that make up HC are shown in Table 1. The use of Brooking's framework is helpful in that it: (i) provides an analytical foundation; (ii) enables HC attributes to be identified in more detail, that is, by firm; (iii) recognises both HC assets and HC liabilities so as to avoid overstating HC by ignoring HC liabilities.

Table 1: List of Human Capital Attributes

1. Know-how	10. Employment safety	18. Employee share scheme
2. Education	11. Union activity	19. Employee share option scheme
3. Vocational qualifications	12. Employee numbers	20. Growth/renewal ratios: average professional experience
4. Employee involvement in the community	13. Employee thanked	21. Growth/renewal ratios: average education level
5. Career development	14. Employee featured	22. Efficiency ratios: V.A./expert
6. Entrepreneurial spirit, innovativeness, proactive and reactive abilities, changeability	15. Executive compensation plan	23. Efficiency ratios: V.A./employee
7. Training programs	16. Employee compensation plan	24. Stability ratios: expert seniority
8. Equity issues: race, gender, and religion	17. Employee benefits	25. Stability ratios: median age of employee
9. Equity issues: disable issues		

The previous literature indicated at least four reasons that could be attributed to why firms might make voluntary HC disclosure in their annual reports. First, IC information, of which HC is a key element, enables firms to create an image of its hidden value (Ordenez de Pablos, 2002). Second, a review of the literature indicates that managers do not often link the value of HC to the performance of the firm (Miller, DuPont, Jeffrey, Mahon, Payer & Starr, 1999) and do not strategically utilise it as an asset (Rodwell, 2000). HCR enables firms to communicate the link between HC and the performance of the firm to their stakeholders. Third, as Grojer (1997) points out inclusion of HC in annual reports could change the elite social order in firms. However, some others believe that publicity leads some firms to mimic the ‘best practice’ firms (Petty & Guthrie, 2000). Fourth, Roslender & Fincham (2001) argue that HC

disclosure promotes a higher level of awareness of the involvement of the stakeholder in the broader context of the firm.

Voluntary HC disclosures made by firms in Sri Lanka could be attributed to the following three factors. First, the *Code of Intellectual Property Act 1979*, recently underwent amendments, to align itself with the government's initiative to make knowledge the core capital of economic development, and also to honour international obligations (*Code of Intellectual Property Act No.40 2000*). As Bontis (1998) states HC is important because it a source of innovation and strategic renewal. Within that context the HC reported by firms in their annual reports appears to legitimate the initiatives of the government. Second, although there are no disclosure requirements in relation to HC and firms do not have strong incentives to disclose information voluntarily (Bassi *et al.*, 2000, p. 356-357), recent trends show that the accounting profession has recognised the importance of HCR for strategic positioning by providing information to enhance the firm's competitive advantage (Roslender, 1997; Roslender & Dyson, 1992; Turner, 1996). This competitive advantage flows from creating, owning, protecting, and making it difficult to imitate, commercial and industrial knowledge assets (Teece, 1986). Third, the disclosure of HC information would also make managers more accountable and transparent to the stakeholders (Bassi *et al.*, 2000, p. 370-380).

Firm size is a variable that must be taken into account in this present study. This has been done, to some extent, via the selection of the sample companies, who were chosen on the basis of market capitalisation. Since this study focuses on those aspects of HCR not mandated by accounting standards and the law, the selection of firms by market capitalisation has allowed us to identify precisely those firms that set standards in voluntary reporting in areas such as HC.

The IC information collected from the analysis of annual reports was coded separately for two consecutive years. Each IC line item was recorded by line count and by frequency of occurrence under the 'HC' category. The frequency and line count for each IC line item was aggregated for the total sample, 30 companies, to analyse results since the number of companies in the sample did not change during the two years. The frequency was determined by the number of times an IC item was described, whether qualitatively or quantitatively. Of the four available methods of counting units (i.e. word or phrase, theme, character and set of interactions), the 'word unit' method was chosen because it is easily identifiable in annual reports. In the word count category, the line (sentence) count was chosen as the context unit instead of the word, paragraph or page, partly because sentences are more easily identifiable wholes (Carney, 1972, p. 58), and partly to ensure that units were measured in such a way as to precisely establish their meaning. Sentences are also given preference in the case of written communication if the task is to infer meaning (Gray, Kouhy & Lavers, 1995).

The line count method of measuring data was chosen for two reasons. First, it is more appropriate than the word count method for drawing inferences from the narrative statements that characterise annual reports. Second, the line count method makes the quantification of charts, tables and photographs easier, by simply converting them into equivalent lines. The alternative, the word count method, was rejected on the basis that it can result in an overly subjective assessment because of the difficulties involved in measuring units such as charts, tables and photographs. Line count data of annual reports were standardised to an A4 page line as the standard unit of measurement. Semantic content analysis was chosen on the grounds that the purpose of the analysis was to count pre-determined IC items referred to in the annual reports. This is because semantic content analysis classifies signs according to

their meanings compared to pragmatic content analysis, which classifies signs according to probable causes or effects (Andren, 1980, p. 56).

In summary, the Sri Lankan case provides an opportunity to fill a significant gap in HC research, by examining a developing country that is nevertheless rich in HC resources. This paper's analysis of Sri Lanka is based on an examination of the annual reports of firms selected according to their level of market capitalisation. To do this an established analytical framework, with some modifications, is used.

4. Results

Over the two years examined, it was found that companies in Sri Lanka demonstrated insignificant increase in the three categories of IC reporting both by frequency and line count, as shown in *Table 2: Overall results by IC category*. The most reported category, both by frequency and line count, was External Capital, followed by HC which was the second most reported category both by frequency and line count.

Table 2: Overall results by IC category

	1998/1999 by frequency	1999/2000 by frequency	1998/1999 by line count	1999/2000 by line count
Internal capital	412	413	1684	1491
External capital	702	964	2984	3319
Human capital	596	790	3260	3200
Total	1710	2185	7928	8010

The least reported category, Internal Capital, reported a decrease by line count as shown above.

Table 3: Human Capital Results by the Coding Framework. 'Employee features' (no. 14), which includes mentioning their names or putting their photograph in annual reports, was the most notable attribute in the HC category, standing out by both frequency and line count. This feature alone accounted for one half of the HC category results. Information about the 'value added by employees' (no. 23) to the firm was the second most important item, followed by 'training programs' (no. 7). Information about the 'entrepreneurial qualities' (no. 6) of employees was found to be the fourth most important by frequency, and fifth by line count. The information about headcount, thanking employees for their efforts, and relationships with unions, were also notable items, their rankings varying slightly from frequency to line count. The items least reported by companies were vocational qualifications, employee equity related issues and compensation plans specific to executive staff (Table 3).

5. Discussion

One purpose of this research, as noted in the introduction, is to examine the status of HCR as demonstrated in the annual reports of large listed companies in Sri Lanka. Featuring employee contribution was the most notable HC attribute found in the annual reports. Such features generally involve recognising the employee's effort and commitment towards the firm. Featuring them through photographs tend to convey a kind of truth that cannot be matched by objects (Sless 1981, p. 74). Graves, Flesher & Jordan (1996) suggest that a television-based format allows firms to assert their truth claims unobtrusively to the stakeholders. From the firm's perspective, this type of disclosure is intended to motivate employees, increase their loyalty to the firm and set an example of positive contribution to other employees. It is interesting to note that the group of employees most featured were from

senior and middle management, which it could be argued represents the most value-adding group of employees in the firm.

Table 3: Human Capital results by the coding framework

HUMAN CAPITAL ATTRIBUTES	1998/1999 by frequency	1999/2000 by frequency	1998/1999 by line count	1999/2000 by line count
1. Know-how	4	12	20	21
2. Education	17	-	16	-
3. Vocational qualifications	-	1	-	1
4. Employee involvement in the community	3	3	21	7
5. Career development	3	2	7	5
6. Entrepreneurial spirit, innovativeness, proactive and reactive abilities, changeability	58	39	155	81
7. Training programs	63	53	293	197
8. Equity issues: race, gender, and religion	10	8	8	8
9. Equity issues: disable issues	4	1	6	1
10. Employment safety	3	11	5	25
11. Union activity	5	13	25	67
12. Employee numbers	53	30	139	89
13. Employee thanked	22	38	105	55
14. Employee featured	201	392	1,598	1,628
15. Executive compensation plan	-	-	-	1
16. Employee compensation plan	4	22	20	33
17. Employee benefits	19	23	26	47
18. Employee share scheme	13	13	38	39
19. Employee share option scheme	19	22	78	52
20. Growth/renewal ratios: average professional experience	8	2	31	14
21. Growth/renewal ratios: average education level	5	3	207	40
22. Efficiency ratios: V.A./expert	-	8	-	15
23. Efficiency ratios: V.A./employee	68	76	313	533
24. Stability ratios: expert seniority	8	11	83	147
25. Stability ratios: median age of employee	6	7	66	94
Total	596	790	3,260	3,200

The second most reported item of HC was information regarding the ‘value added by employees’ (no. 23). This could be understood as a way of providing employees with feedback on their performance and to create a benchmark for better performance, with the view to build a stronger relationship between management and employees.

Firms in Sri Lanka have successfully avoided being mandated by their regulators, allowing them to use an unregulated value added statement, with known inconsistencies, that lends itself to manipulation. As confirmed by previous research, reporting the ‘value added by employees’ through value-added statements enables these firms to create an impression to other constituents that they are not solely driven by profits but by the common good of participants. These firms also construct a view through the value-added statement that both management and labour is a single stakeholder, while it is clear that they are two separate stakeholders. Further, these firms manipulate their agenda through this inconsistent unregulated statement without adding any new information to the income statement (Van Staden, 2002).

It also appears that Sri Lankan firms invest a substantial amount into training their workforce. However, the analysis of the annual reports showed that the emphasis of this training was not on direct work-related skills. Rather, most of the training was intended to strengthen the ‘soft qualities’ of employees, such as employee conduct, attitudes, willingness to learn and relationship building skills. Relationships between employees and the firm are far more important in the Sri Lankan context, which is probably due to the Sri Lankan culture. The Sri Lankan case contributes to our understanding of the ‘entity’ view of the firm (Blair, 1999, p. 58-90). The ‘entity’ view of the firm argues that the relationship between employees and the firm are the most important factor in retaining employees. The theory of the firm most widely

accepted at present assumes that there exists a certain, narrowly defined kind of relationship between shareholders and managers. It is also based on the implicit assumption that the firm is a bundle of assets delegated by owners to managers who are tasked with managing these assets. However, modern management is increasingly interested in addressing the complex role of human input into the life of the firm, and is increasingly cognisant that HC cannot be treated as something separate from corporate governance (Blair, 1999, p. 58-90).

In line with the above, it appears that firms in Sri Lanka tend to rely on their employees' tacit knowledge base to leverage the firm's knowledge, rather than concentrating their energies on the direct codification of knowledge. This is accomplished by encouraging an emphasis on relationship building within the firm, indirectly promoting 'communities of practice' among employees. This practice is similar to that of many successful Japanese companies, as found by Nonaka (1991). In these companies, it was found that knowledge creation was viewed as a process of tapping into the tacit knowledge, insights, intuitions and hunches of employees, on the basis that new knowledge finds its beginnings in the individual.

Few annual reports indicate strained relationships with unions, with some firms even appearing to enjoy a positive management-union relationship. The annual reports seem to indicate that those companies enjoying such a positive relationship are involved in a process of continually creating a culture of trust, with some of their training programs specifically being geared towards achieving that objective.

The 'headcount of firms', one of the attributes given in the coding framework, was outside the list of the five most important HC items. This probably reflects the fact that firms in Sri Lanka are continually restructuring to adopt new technology in order to replace low value

adding activities. It could also be one of the reasons why details on the ‘vocational qualifications of employees’ were least mentioned.

The reasons for the low level of reporting on executive compensation plans are unclear. It is possible however, that such information could increase the political visibility of the firm amongst lobby groups and invite counter action by unions. ‘Equity issues’ are also one of the least mentioned in the annual reports, with only one firm reporting opportunities offered for disabled employees. The lack of infrastructure to facilitate disabled workers to commute to work, and also to provide workers compensation insurance for disabled persons at employment is in line with the ‘political’ view that government would like to keep a low profile about their attitude towards providing employment opportunities for disabled people. Promoting opportunities for disabled people forces the government to further support them with infrastructure and other compensatory costs, which add to the government’s already demanding budgetary burdens (UNDP Sri Lanka 1998, p. 5-42). Reporting more about employment or lack of employment opportunities for disabled people can, therefore, create tension between the firms and the government. This is an area that firms in Sri Lanka need to strengthen in order to contribute to the development of HC and in order to enhance their corporate image as responsible corporate citizens.

By comparison, the findings of a similar study carried out by Guthrie *et al.* (1999) into the top 20 Australian companies highlights the reporting attributes of HC in a developed country such as Australia. ‘Entrepreneurial spirit’ was the most frequently reported attribute of HC in Australia (Guthrie *et al.*, 1999; Guthrie & Petty, 2000), as opposed to the ‘featuring of employees’ in Sri Lanka. In contrast, ‘entrepreneurial spirit’ was one of the least reported items in Sri Lanka. Firms in Australia are at the forefront of R&D and the business culture

provides incentives to encourage the entrepreneurship of employees. The cost of innovation is not an issue and the innovators in Australia do not have to worry about the product having a high initial price. The products in developed countries such as Australia go through the initial phase into the growth stage where such products become widespread in the national market. The investors are willing to support such entrepreneurship because such markets have the ability to accept the risk of innovation and reap the benefit of success through high initial market prices. The product cycle almost always begins in high-income market economies through their entrepreneurial culture for product innovation. They provide an environment conducive to technological innovation and flexible risk insurance facilitating the commercial application of such technological change. When the product has reached standardisation of production, it becomes cheaper to manufacture it in a low-wage developing economy with technologies recycled by developed countries, this in turn maximises the firm's capital accumulation (Isaak 1991, p. 169-171). However, developing countries such as Sri Lanka, cannot multiply their capital through comparable entrepreneurship because it already is a low price market.

'Work related knowledge' was the second most important HC attribute in Australia, whereas in Sri Lanka 'value added by employees' ranked second. This comparison between Australia and Sri Lanka points to a clear difference in values. It seems that Sri Lankan firms are more results driven in their assessment of HC, emphasising the recognition of employee contribution to the firm and reporting on value added by employees. Australian firms, on the other hand, seem to be more process driven, emphasising the entrepreneurial qualities of employees and their work related knowledge. In as much as it is possible to generalise from this brief comparative analysis between Sri Lanka and Australia, it can be argued that the differences between HCR of firms located in developing and developed countries can be

attributed to the differences in their political, social and economic institutional frameworks. This study provides a brief introduction to the differences of approach in two nation states that point towards differences in the context of HCR in developed and developing nations. Further research will be required to flesh out these initial insights.

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